

# MONETARY BULLETIN 2010

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In the last few months, the development of the Latvian economy, in particular the indicators of business and consumer confidence and exports, pointed to ongoing stabilisation of the economy. The situation in the financial markets was also stable, supported by the disbursement of the next instalment of 0.5 billion euro from the European Commission loan as part of the multilateral financial assistance package after the successful fiscal consolidation measures taken and approval of the budget for 2010. The rating agency Moody's upgrading of its outlook on Latvia from negative to stable suggested that Latvia was regaining foreign investors' confidence. In view of the economic stabilisation and receding inflation risks, the Bank of Latvia Council lowered the refinancing rate from 4.0% to 3.5% as of 24 March. In order to promote predictability of the banking system liquidity, a new monetary instrument – a 7-day deposit facility with the Bank of Latvia with the interest rate of 1.0% – was introduced. In order to motivate banks to channel their resources into the development of the economy, the overnight deposit facility rate with the Bank of Latvia was reduced from 1.0% to 0.5%.

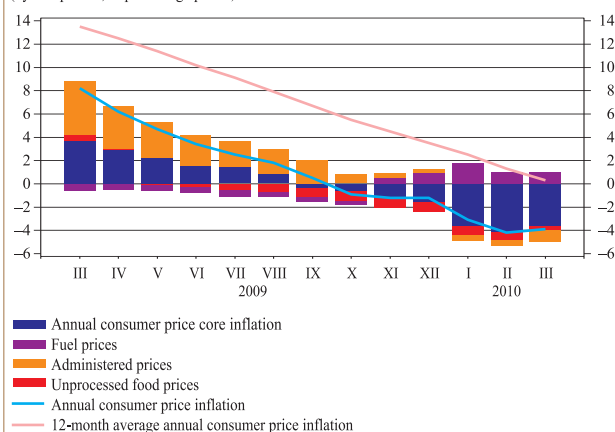
In February, the retail trade turnover decreased by 0.9% month-on-month (seasonally adjusted data), whereas its year-on-year decrease of 13.3% (working day adjusted data) was more moderate than in January. In February against January, the seasonally adjusted volume of industrial output in manufacturing decreased by 2.6%, while on an annual basis and according to the working day adjusted data output grew by 1.3%. In March, Latvia's freight transportation indicators worsened: rail freight in Latvia contracted by 8.1% year-on-year, and total freight turnover at Latvian ports shrank by 2.8%. Meanwhile, the unemployment rate continued to rise, albeit less dynamically than in the previous months, amounting to 17.3% at the end of March.

In March, consumer prices rose by 0.5% month-on-month. As new collections appeared in the shops, prices of footwear and clothing increased; vegetables and fruit also became more expensive due to seasonal factors. Fuel price rises made a substantial upward contribution. For the first time since May 2008, the annual rate of change of the consumer price index reversed and deflation and annual core inflation shrank to 3.9% and -5.0% respectively. The average 12-month inflation was still in positive territory at 0.3%, while the average 12-month growth of the harmonised index of consumer prices (HICP), an indicator used for the Maastricht criterion, dropped to 0.1%.

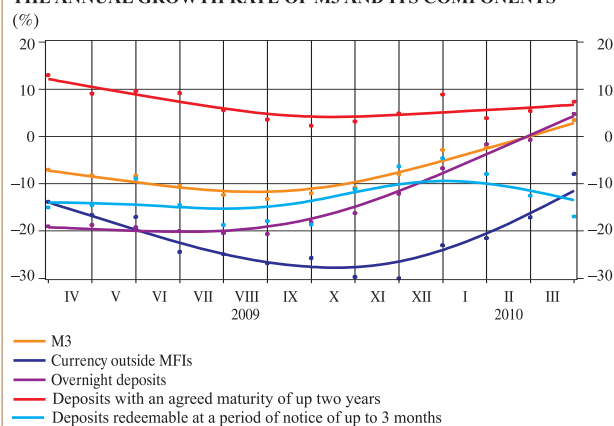
In March, the general government consolidated budget ran a deficit of 115.5 million lats; the deficit accrued since the beginning of the year stood at 132.7 million lats. A surplus was recorded only in the local government budget, with deficits building up both in the central government basic budget and central government social security budget. The annual rate of decrease in tax revenue (5.3%) was considerably lower than in February as only corporate income tax collection posted a substantial fall. With revenue from foreign financial assistance growing, the annual growth of total budget revenue in March increased by 7.6%. Budget expenditure contracted by 1.3%, the fall being downsized by a pickup in the expenditure on social benefits and pensions and interest expense. The general government debt increased by 443.9 million lats (primarily due to financing received from international lenders) in March, amounting to 4 911.3 million lats.

Money supply continued to expand notably in March. Following a longer period of decline, the annual rate of change of

**ANNUAL CONSUMER PRICE INFLATION**  
(by component; in percentage points)



**THE ANNUAL GROWTH RATE OF M3 AND ITS COMPONENTS**



monetary aggregates M1, M2 and M3 returned to positive territory again, reaching 1.8%, 3.2% and 3.5% respectively. Money supply developments were affected by a rapid increase in overnight deposits (4.3%), as well as a moderate pick-up in deposits with an agreed maturity of up to 2 years (1.7%) and currency outside MFIs (0.4%). Deposits redeemable at notice contracted by 2.9%.

In March, deposits of resident financial institutions, non-financial corporations and households expanded by 2.5%, with the annual growth rate of deposits reaching 6.0%. The ample lats liquidity and the inflow of government funds in the financial system via converting the funding received under international loan agreements into lats continued to contribute to an accelerated increase in deposits in lats. In March, the negative annual rate of change of household deposits decreased to -0.4% while deposits of financial institutions and non-financial corporations posted 14.5% year-on-year growth.

On the backdrop of precautionary lending policies pursued by most banks with respect to granting new loans due to the high share of delinquency and the persistently low demand for loans, the loans to financial institutions, non-financial corporations and households continued to decrease also in March (by 1.0%), with the annual rate of decrease in loans reaching 8.0%. Nevertheless, in March loans granted to non-financial corporations and households recorded the same annual rate of decrease as in February - 7.2% and 5.0% respectively.

Funding from foreign banks to the banking sector continued on its downward trend as outstanding syndicated loans and liabilities to parent banks abroad decreased, while non-resident non-MFI deposits expanded. As foreign assets of the banking sector grew by 159.7 million lats in March, the negative net external assets of MFIs (except the Bank of Latvia) improved by 236.7 million lats.

In March, the monetary base M0 shrank on account of banks largely resorting to the 7-day deposit facility with the Bank of Latvia (671.4 million lats) amidst ample liquidity, thus reducing the balance on the bank correspondent accounts. The negative annual rate of change of the monetary base posted slight changes in March (5.2%). An increase in the government deposit in lats with the Bank of Latvia (33.8 million lats) had a dampening effect on the money supply of the central bank.

The substantial growth of the Bank of Latvia's net foreign assets resulted from changes in the foreign currency deposits made by the government. With the disbursement of the next instalment of the international loan from the European Commission, the central bank's net foreign assets expanded by 375.4 million lats or 10.7%, reaching a high of 3.9 billion lats. At the end of March, the backing of the national currency with the Bank of Latvia's net foreign assets was 266.2%.

With surplus liquidity persisting, the interbank market interest rates remained low. In March, the weighted average interest rate on overnight loans was a mere 0.98%, close to 1% for the seventh consecutive month. RIGIBOR on overnight loans declined from an average 1.27% in February to 1.22% in March. Longer-term RIGIBOR also continued on a downward trend: 3-, 6-, and 12-month RIGIBOR fell to 2.16%, 2.63% and 3.77% respectively. Interest rates on loans granted to households (except those on loans in lats for house purchase) and those on loans in foreign currencies to non-financial corporations moved up while interest rates on almost all types of deposits (except non-financial corporation time deposits in foreign currencies) recorded a fall.

In March, the exchange rates of the US dollar, British pound sterling, and Japanese yen set by the Bank of Latvia against the lats depreciated by 0.2%, 2.2%, and 3.4% respectively.

MACROECONOMIC INDICATORS	2010	
	II	III
Volume index of industrial output (working-day adjusted annual rate of change; %)	4.0	*
Changes in the CPI		
Month-on-month basis (%)	0.0	0.5
Average annual inflation rate (HCPI) of last 12 months (%)	1.3	0.3
Year-on-year basis (%)	-4.2	-3.9
Annual rate of core inflation <sup>1</sup> (%)	-5.6	-5.0
Number of registered unemployed persons (at end of period)	192 032	194 253
Unemployment rate (%)	17.1	17.3
General government consolidated budget financial deficit/surplus (in millions of lats)	-17.2	-132.7
Foreign trade (in millions of lats)		
Exports	313.0	*
Imports	377.2	*
Balance	-64.2	*

<sup>1</sup> Source: Bank of Latvia.

\* Figure available at a later date.

Source: Central Statistical Bureau of Latvia and Ministry of Finance.

**MONETARY INDICATORS** (at end of period; in millions of lats)

	2010	
	II	III
<b>MFIs<sup>1</sup></b>		
<b>M3</b>	5 944.5	6 081.0
Repurchase agreements	0	0
Money market fund shares and units	101.8	98.3
Debt securities issued with maturity of up to 2 years	0.9	0
<b>M2</b>	5 841.8	5 982.7
Deposits with agreed maturity of up to 2 years	2 596.1	2 641.2
Deposits redeemable at notice of up to 3 months	248.2	241.0
<b>M1</b>	2 997.5	3 100.4
Currency outside MFIs	666.5	669.2
Overnight deposits	2 331.0	2 431.2
Net external assets	-2 551.9	-1 939.7
Credit to resident financial institutions, non-financial corporations and households	13 352.9	13 217.3
Credit to general government	644.0	664.3
Deposits of central government	2 046.4	2 293.3
Longer-term financial liabilities	2 301.6	2 223.6
<b>Bank of Latvia</b>		
<b>M0</b>	1 923.5	1 464.9
Currency in circulation	767.7	774.2
Deposits with the Bank of Latvia in lats	1 144.9	673.9
Deposits with the Bank of Latvia in foreign currencies	10.9	16.7
Net foreign assets	3 524.3	3 899.7
Net domestic assets	-1 600.8	-2 434.9
Credit	-1 216.8	-1 460.3
To MFIs	117.6	117.6
To central government (net)	-1 334.4	-1 578.0
Other items (net)	-384.0	-974.5
International reserves (at end of period; in millions of euro)	5 066.17	5 569.59
Gold	201.71	204.68
Special Drawing Rights	137.54	136.16
Reserve position in the IMF	0.06	0.06
Foreign convertible currencies	4 726.86	5 228.69
International reserves (at end of period; in millions of US dollars)	6 820.93	7 513.08
Gold	271.58	276.11
Special Drawing Rights	185.17	183.67
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	6 364.10	7 053.22

<sup>1</sup> In accordance with the methodology of the European Central Bank.

**EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES**

	2010	
	II	III
Weighted average interest rate on domestic interbank loans in lats	1.0	1.0
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	7.2	4.4
Loans to households (in lats)	12.7	16.2
incl. for house purchase	9.4	8.3
Loans to non-financial corporations (in foreign currencies)	5.1	5.2
Loans to households (in foreign currencies)	4.9	5.4
incl. for house purchase	3.9	4.0
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	3.6	2.7
Demand deposits of non-financial corporations (in lats)	0.5	0.4
Time deposits of households (in lats)	6.8	5.3
Demand deposits of households (in lats)	1.0	0.7
Time deposits of non-financial corporations (in foreign currencies)	0.7	0.9
Demand deposits of non-financial corporations (in foreign currencies)	0.2	0.2
Time deposits of households (in foreign currencies)	1.8	1.5
Demand deposits of households (in foreign currencies)	0.6	0.5
The Bank of Latvia's refinancing rate (at end of period; %)	4.0	3.5
Exchange rates of foreign currencies (at end of period)		
LVL/USD	0.5220	0.5210
LVL/GBP	0.8000	0.7820
LVL/100 JPY	0.5840	0.5640
LVL/EUR	0.7028	0.7028

**AGGREGATED BALANCE SHEET OF MFIs (EXCLUDING THE BANK OF LATVIA)** (at end of period; in millions of lats)

	2010	
	II	III
MFI reserves	1 359.8	1 461.5
Vault cash in national currency	101.3	105.0
Deposits with the Bank of Latvia	1 258.5	1 356.5
Foreign assets	4 500.4	4 660.1
Vault cash in foreign currencies	67.4	67.9
Claims on MFIs	2 601.0	2 739.7
Claims on non-MFIs	1 724.3	1 768.4
Other assets	107.6	84.1
Claims on central government	574.4	600.5
Claims on local government	69.6	63.8
Claims on public non-financial corporations	405.8	403.8
Claims on financial institutions and private non-financial corporations	7 065.6	6 972.8
Claims on households	6 045.3	6 013.1
Unclassified assets	913.0	905.7
Fixed assets	144.9	135.2
Items in transit	16.3	18.5
Other assets	460.0	470.9
Claims on resident MFIs (incl. investments)	291.9	281.2
<b>Total assets</b>	<b>20 934.0</b>	<b>21 081.4</b>
<i>Memo item: Trust assets</i>	<i>430.2</i>	<i>422.1</i>
Overnight deposits in lats	1 147.5	1 210.9
Public non-financial corporations	73.1	93.8
Financial institutions and private non-financial corporations	532.7	519.6
Households	541.7	597.5
Time deposits and deposits redeemable at notice in lats	1 244.6	1 268.1
Public non-financial corporations	245.6	262.3
Financial institutions and private non-financial corporations	445.6	470.2
Households	553.4	535.5
Foreign currency deposits of residents	2 792.7	2 833.0
Public non-financial corporations	34.2	82.7
Financial institutions and private non-financial corporations	1 022.3	1 026.6
Households	1 736.1	1 723.7
Deposits of central government	711.9	715.4
Deposits of local government	147.1	159.8
Transit funds	3.0	3.0
Foreign liabilities	10 576.5	10 499.6
Liabilities to MFIs	6 939.9	6 563.9
Liabilities to non-MFIs	3 113.6	3 262.2
Other liabilities (incl. subordinated liabilities)	523.0	673.5
Liabilities to the Bank of Latvia	118.1	117.6
Debt securities issued	158.6	157.8
Money market fund shares and units	101.8	98.3
Capital and reserves	1 677.4	1 595.2
Residents	432.5	350.1
Non-residents	1 244.8	1 245.1
Provisions	1 604.9	1 707.1
Unclassified liabilities	649.9	715.6
Items in transit	84.6	94.6
Other liabilities (incl. subordinated liabilities)	298.7	372.1
Liabilities to resident MFIs	266.5	248.9
<b>Total liabilities</b>	<b>20 934.0</b>	<b>21 081.4</b>
<i>Memo item: Trust liabilities</i>	<i>430.2</i>	<i>422.1</i>

The IMF's Dissemination Standards Bulletin Board (<http://dsbb.imf.org>) disseminates the release dates for monetary indicators of the Latvian banking system, monetary indicators of the Bank of Latvia and international reserves. The data are first made available on the Bank of Latvia's website (<http://www.bank.lv>).